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Federal Open Market Committee

Conference Call

July 19, 1988

PRESENT: Mr. Greenspan, Chairman
Mr. Corrigan, Vice Chairman
Mr. Angell
Mr. Black
Mr. Forrestal
Mr. Hoskins
Mr. Johnson
Mr. Parry
Ms. Seger

Messrs. Guffey, Keehn, Melzer, and Morris,
Alternate Members of the Federal Open Market
Committee

Messrs. Boehne, Boykin, and Stern, Presidents
of the Federal Reserve Banks of Philadelphia,
Dallas, and Minneapolis, respectively

Mr. Kohn, Secretary and Economist
Mr. Bernard, Assistant Secretary
Mr. Bradfield, General Counsel
Mr. Prell, Economist
Mr. Truman, Economist

Messrs. Lindsey and Slifman, Associate Economists

Mr. Sternlight, Manager for Domestic Operations,
System Open Market Account
Mr. Cross, Manager for Foreign Operations,
System Open Market Account

Mr. Coyne, Assistant to the Board, Board of
Governors

Mr. Promisel, Senior Associate Director, Division
of International Finance, Board of Governors

Ms. Low, Open Market Secretariat Assistant,
Division of Monetary Affairs, Board of
Governors

Mr. Oltman, First Vice President, Federal Reserve
Bank of New York

Transcript of Federal Open Market Committee Conference Call
of July 19, 1988

[Secretary's note: No transcript exists for the initial portion of this conference call, which apparently consisted largely of reports by the Managers for Domestic Operations and Foreign Operations and comments by staff members on economic and financial developments.]

CHAIRMAN GREENSPAN. As I see the outlook, I find it difficult not to envisage our having to tighten further as we move into the summer months. But it strikes me that with the continued strength in the dollar, if we were to do so at this stage, we would probably accelerate the dollar's strength and initiate some fairly broad increases in interest rates amongst our trading partners, which could create some international instability. I would be inclined at this stage to hold off until we get the dollar stabilized before we take another shot at it, but my suspicion is that it's probably only a matter of a few weeks away. In any event, I'd be very curious to get the impressions of those around the table here and those on the telephone.

MR. PARRY. Mr. Chairman?

CHAIRMAN GREENSPAN. Yes.

MR. PARRY. Bob Parry.

CHAIRMAN GREENSPAN. Yes, Bob.

MR. PARRY. My understanding is that, if we stick with the \$600 million borrowing target, the expectation of Peter and Don is that the funds rate is likely to decline to what we thought were the estimates consistent with that--roughly 7-1/2 percent or slightly higher. If that is the case, is that the message we want to give at this point, given that we've seen funds trading at quite a higher level for a few days?

CHAIRMAN GREENSPAN. I would say that the message we certainly don't want to communicate is that we're backing off.

MR. PARRY. That's my concern.

CHAIRMAN GREENSPAN. I would certainly agree with that. And I think that impression wouldn't occur if we slipped back for a while but it would occur if we slipped under [unintelligible].

MR. PARRY. Right.

CHAIRMAN GREENSPAN. And I would say that should any evidence of that impression occur, I think we would have to take actions to offset that.

MR. PARRY. I guess my concern is that that impression is likely to develop if funds were to move down to 7-1/2 percent or a smidgen higher.

CHAIRMAN GREENSPAN. Well, why don't all the members address themselves to that issue? I think it would be useful to get the Committee's view on that, should any evidence create that impression. My own view is that it's probably unlikely. I'm not sure at this stage but, at least judging from the Money Market report, that report has actually got us right on.

MR. KOHN. The Money Market report has the funds rate at 7-5/8 percent.

CHAIRMAN GREENSPAN. It has \$600 million borrowing and 7-5/8 percent. So the impression I get at this stage is that there may be some out there who would have that impression, but I would doubt very much whether or not it's really significant or prevalent. But if anyone has any dissenting views on that, it would be useful to hear them.

MR. BOEHNE. Mr. Chairman, I'm just recalling Peter Sternlight's report of a few moments ago where he indicated--if I heard him right--that there was a fairly widespread view that there has been some additional snugging up and that that view is seen as consistent with your testimony of last week. At least looking at such widely read publications as the Wall Street Journal, that also seems to be the case. I would think that, given the impression that we're trying to put out there that we want to stay ahead of the inflation curve, that's the kind of environment where we ought to err on the side of resisting inflation. To let the funds rate slip back at a time when there does seem to be a widespread view that we've snugged up would be a source of considerable confusion. And so my preference would be to try to lock in what we have backed into, which I take it is a funds rate of around 7-3/4 percent.

MR. BLACK. Mr. Chairman, Bob Black. I agree with Bob Parry and Ed Boehne on that.

MR. MORRIS. Mr. Chairman, Frank Morris. I also agree for the reasons stated. Also, it seems to me that, given the June employment figures--even with the seasonal adjustment problems--and given the strength of purchasing orders, the economy is stronger than we thought it was at the time of the FOMC meeting.

CHAIRMAN GREENSPAN. I think that's correct. However, let's remember we're not trying to fine tune the funds rate.

MR. ANGELL. I would certainly support the Chairman's position, which is that the dollar strength may very well be a matter of days or weeks. And it would be much better for us to make a move later if another move is needed. It's really a long summer and it's a long year; we don't have to gain our credentials every day. And it really isn't quite appropriate if we're going to have a borrowing target to let misperceptions concerning what we might do be validated. It seems to me that we ought to be in charge rather than the markets being in charge. And if we simply let ourselves get caught up in doing what the market might think or some participants might think, I believe that's unnecessary. So, I'd support the Chairman's view of seeing where we go on the international front, and then if we need to, make some moves there. We may need to make even more decided moves than we're thinking about now if the dollar were to come back off. It

seems to me that once the dollar is seen as peaking, and having some downward vulnerability, it might gain quite a bit of potential there. So, I'd prefer to follow the Chairman's view of waiting and staying with the \$600 million.

MR. FORRESTAL. Mr. Chairman, this is Bob Forrestal in Atlanta. My analysis would tend to support your view that a move now would not be called for. I, too, would like to wait a couple of weeks, particularly since we've got some additional numbers like the trade numbers coming out soon. On the other hand, while it may be unlikely that the market is going to have the funds rate move down to 7-1/2 percent, if that were to happen I think we ought to begin to resist it at about 7-5/8 percent. I agree that we're not fine tuning the funds rate, but I think that if we don't hold the line at something above 7-1/2 percent, we may very well be sending the wrong message to the markets.

MR. HOSKINS. Mr. Chairman, Lee Hoskins.

CHAIRMAN GREENSPAN. Yes, Lee.

MR. HOSKINS. First, I'd like to applaud your testimony, particularly the statements with respect to your definition of what you mean by price stability and what I thought was the tone that the risks are, if not definite, toward inflation. But going from there, it seems to me that to stay where we are now is somewhat inconsistent with that view of the world. I remember at the last meeting that we adopted the idea that we would watch for some new data coming out and the data have now come out. But, as we look at it here, any particular weakening in the economy [unintelligible]. There's nothing there that would cause me concern. Again, I agree the complication is the exchange rate, but I don't know what is appropriate, and I doubt whether anyone around this conference call knows what is appropriate. I guess what I'm saying is that I don't think we ought to gear policy to that [unintelligible] variable, even for a short period. I reluctantly went along with waiting for new information at the last FOMC meeting. We were talking about an alternative C there, which I was in favor of, and it was \$750 million on borrowing and an 8 percent funds rate. It seems to me that the information we have seen to date ought to at least validate where we are and where I think the market should be and move on toward the \$750 million. That would be my view [unintelligible]; we ought to be leading the market. I think right now we run the risk of generating more confusion in the market by staying with the current borrowing target.

MR. GUFFEY. Mr. Chairman?

CHAIRMAN GREENSPAN. Mr. Corrigan is first.

VICE CHAIRMAN CORRIGAN. Backing up just a bit, my own assessment of the economic data that have become available since the last FOMC meeting is that--even with all the twists and turns that can be put on them--on balance, they are stronger than I think was being implicitly contemplated at the time. And I also viewed with some concern the PPI numbers, even though I think the Chairman's comments about the dynamics of what's going at the PPI level are probably quite accurate at this point in time. Now on the basis of the economic information, taken at face value, I think that the case for a further

increase in the borrowings level at this time is absolutely compelling. But I do recognize that the fly in the ointment at the moment is the dollar. Left to my own druthers, I might say ignore the dollar and go ahead and increase the borrowings anyway. But that is a bit of a high risk strategy, at least in the context of, say, the next week or two.

Now, insofar as the dollar is concerned, I remain of the view that, over time, the greater probability is a dollar that is weak rather than a dollar that is strong. And I think that in the current setting we do have some elements of a speculative move here, as Sam Cross has said. Certainly, there is a widespread view, reflected in the newspapers and conversations and so on, that a rising dollar is incompatible with the international adjustment process that still lies ahead. So, I wouldn't be surprised to see the dollar cool off, as it may be doing a bit now. But if we're going to condition the near-term tactics of monetary policy on the dollar, I for one would be willing to be--and indeed would urge that we be--a little more forthcoming in terms of what we do and what we say about the dollar in an effort to try to get over this hump as quickly as possible; because with or without a strong dollar, I think that a greater degree of monetary restraint is needed. Indeed, as I said, I think it's needed rather badly. I could live with leaving borrowings where they are for another week or two in the hopes that the dollar situation would rectify itself with a continuing nudge from us and others. But even in that context, I would hope, if that were the view of the Committee, that we would have a decided tilt to day-to-day operations so as not to permit backsliding in the funds rate that would end up giving, I think, potentially very misleading signals to the markets--and, indeed, to the exchange markets--as to where we are. And the chances of getting the dollar to cool off if the market thinks that we're letting interest rates come down are very slim indeed. It's fundamentally incompatible with what we're trying to do on both scores. So, I think we have to be very, very careful about that.

CHAIRMAN GREENSPAN. Any further comments?

MR. KEEHN. I agree with what Jerry just said. I think the strength in the economy is continuing to move along; and in a purely domestic context, I'd be in favor of continuing to move up the borrowing level now. The exchange value of the dollar surely complicates it, and I don't think we want to do anything that would exacerbate a trend that doesn't seem to be permanent. Therefore, I'm in favor of what you're suggesting--namely, that we simply hold for an additional fairly brief period and watch it carefully. If the dollar begins to move down, though, I think we ought to make another move on the borrowing level.

MR. JOHNSON. I have a couple of comments. I'm with the Chairman all the way on his view. I think we ought to wait a bit. In addition, I'm not totally convinced that this dollar thing is temporary at all. I think that the trade numbers have somewhat defied our estimates, and it's quite possible that the models may just be wrong about the kind of trade adjustments we can get at these exchange rates. I also think that a stronger dollar is consistent with a tighter policy, and I don't see how we can avoid those consequences to some extent. I think we can do sterilized intervention until the cows come home and not basically alter that fundamental. To some

extent, I think the exchange rate is helping us out in the conduct of our policy restraint and it should be part of our policy. I know we have international obligations and we should be sensitive to those; and I think we are, through our sterilized intervention actions. But I don't see how we can take these actions and continue to restrain domestic demand and not see that show up in improvement on the trade side and a stronger dollar as well. I'd like to see the lagged effects of that. So far, we just continue to move without waiting for the lagged response. I think we're getting into risky ground if we continue to move in that direction.

MS. SEGER. I would support--

VICE CHAIRMAN CORRIGAN. The problem with that is we haven't really done all that much. If you look at nominal or real interest rates, and if you look at what's going on in the economy, I'm just not persuaded that we've done all that much at all.

MR. JOHNSON. Well, that's your opinion, Jerry. I think we've done a significant amount.

MS. SEGER. I was just going to vote in favor of keeping our powder dry for another two weeks or so to get a chance to look at the major revisions on the GNP accounts and also to watch what's going on in the foreign exchange markets. And like Governor Johnson said, I have a feeling that this strength in the dollar is not just a flash in the pan but there's more there. But at least this would give us more time to decide what's going on.

MR. BOYKIN. Mr. Chairman, this is Bob Boykin in Dallas. I would be inclined to go ahead and make a move right now. Without looking strictly at the perception side of it--that has been discussed a little--it seems to me that with the market [unintelligible] and with our establishment of considerable credibility about our willingness to guard against inflation, the fact that a move would play into the market's expectations would probably be a positive right now. And I think it would have less of an effect on the dollar than if we had to do something a little more stringent or significant two or three weeks from now.

MR. STERN. Mr. Chairman, this is Gary Stern.

CHAIRMAN GREENSPAN. Yes, Gary.

MR. STERN. I would be in favor of raising the borrowing target now. It seems to me that, as several people have already commented, the economy appears to be stronger than we anticipated. I took your discussion about the intermediate component of the PPI and unit labor costs to imply, as well as some of the other things that we've been seeing, that we're probably approaching a critical juncture as far as inflation is concerned. I think both of those factors argue for more restraint. I just don't find the discussions about the dollar very compelling at this point. I don't have a conviction as to where the dollar is going to go next, but I would not be surprised if it were to go higher rather than lower. And it's not at all clear to me what we gain by waiting.

CHAIRMAN GREENSPAN. Roger Guffey, were you trying to get in there before?

MR. GUFFEY. Yes, I was. I've almost forgotten, Mr. Chairman, what I was going to say. But let me say that I would agree with the proposal that you have on the table, Mr. Chairman, for several reasons. Notwithstanding the strength of the dollar, I tend to agree that perhaps lower may be a better projection than higher over some near-term horizon. To move up the borrowing target, and therefore, the interest rate level now, seems to me to be a little premature. If indeed the dollar were to decline a bit, then it would be time to raise the discount rate perhaps, or even to go further in open market operations. On the other hand, I don't see any emerging evidence of inflation yet. I agree that we ought to move before that occurs, but the case just isn't very strong, in my mind. And I would remind everyone that there remains a good deal of fragility in the financial system. And the interest rate level, particularly for the S&Ls, is a very important ingredient as to their health in the future. If indeed we will need to raise interest rates--and I'm sure we will sometime in the future--I'd rather wait and see the lagged effects of what we've already done rather than jump out in front.

CHAIRMAN GREENSPAN. Tom Melzer.

MR. MELZER. I'd like to make just one comment. I don't claim to understand what the psychology is in the currency markets right now, but I can imagine circumstances, if you have a lot of speculative activity, that if we were to move very visibly--and I know we're not discussing it right now--for example, with a discount rate increase, speculators might feel that that's going to be the best news they get. And you could actually get dollar weakness out of a move like that, not further strength. I'm just making that observation. But, in general, the thing that concerns me, given this strength that we all seem to see here, is whether we can continue this pattern of sort of following the market with modest moves. I don't feel particularly strongly about moving today versus moving a couple of weeks from now, but at some point I worry that we're going to have to move more forcefully. And the longer we wait to do that, the bigger the stakes become, in a sense.

CHAIRMAN GREENSPAN. Any further comments? As I listen to the discussion I get the following impressions: One, that there is a strong consensus that we not let the market misperceive anything that we do which would suggest a backing off. I think that that's not terribly difficult to avoid; I would suspect that we should be able to do that rather easily. I would also add that we don't really need a dollar decline in this situation; all we need is evidence of stabilization, because it's the rising dollar which is creating problems abroad and is initiating concerns about escalating interest rates. The stable dollar removes that; you don't need a declining dollar for that to happen. However, in view of the differences that we are expressing here, I do think it is important that we revisit this issue in 10 days to 2 weeks, which is sort of half way between now and the next FOMC meeting. At that point, I think we should have a number of things in the foreign exchange markets clarified and we may be feeling a lot more comfortable about moving up at that time. Unless anyone has any further discussions on this, there is a special

issue with respect to a Mexican swap proposal that I'd like Ted Truman to raise.

MR. HOSKINS. Mr. Chairman, this is Lee Hoskins. I have a question on how we are going to [unintelligible] for a borrowing target or interest rates, in convincing the market that we haven't let rates fly back or--

CHAIRMAN GREENSPAN. I think that the Desk has the implicit authority, in the nature of the asymmetry that still exists in the directive, to take small actions within its bailiwick to produce that effect.

MR. HOSKINS. That effect being a 7-3/4 percent funds rate?

CHAIRMAN GREENSPAN. I don't want to discuss this. What I'm saying, basically, is that what I heard from the Committee is that what we should not do is create a situation in which the market begins to doubt what the effective policy of this Committee is. All I can suggest to you is that we will monitor conditions in a manner which [unintelligible]. The types of actions are well within the directive in that respect. But it's quite likely that we may want a full vote in the next telephone conference.

VICE CHAIRMAN CORRIGAN. I agree with that completely, Mr. Chairman.

[Secretary's note: The transcript ends at this point and does not include Mr. Truman's report on the Mexican swap proposal and the ensuing Committee discussion, if any. Subsequent to this conference call, on July 27, Chairman Greenspan sent a memorandum to FOMC members recommending action with respect to a Bank of Mexico request for a drawing on its swap line with the System. That memorandum is appended.]